86-1241

Supreme Court, U.S.
FILED
DEC 29 1986
JOSEPH F. [illegible], JR.
CLERK

In The
Supreme Court of the United States
October Term, 1986

GLENN L. RUDELL, and JEAN C. RUDELL, and EDWARD W. BERGQUIST, as Bankruptcy Trustee for Glenn and Jean Rudell, Minnesota Bankruptcy Court file no. 4-84-230; individually and on behalf of all others similarly situated,

Petitioners,

v.

COMPREHENSIVE ACCOUNTING CORPORATION, COMPREHENSIVE BUSINESS CORPORATION, LEO G. LAUZEN and CHRISTOPHER J. LAUZEN,

Respondents.

Supplemental Appendix to Petition for certiorari to the U.S. Court of Appeals of the 7th Circuit

ARGUED APRIL 15, 1986
DECIDED SEPTEMBER 30, 1986

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IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

GLENN L. RUDELL and JEAN C. RUDELL; and EDWARD W. BERGQUIST, as Bankruptcy Trustee for Glenn and Jean Rudell, Minnesota Bankruptcy Court File NO. 4-94-230; individually and on behalf of all other similarly situated,	)	
Plaintiffs,	)	
v.	)	No. 84 C 5393
COMPREHENSIVE ACCOUNTING CORPORATION, COMPREHENSIVE BUSINESS CORPORATION, LEO G. LAUZEN, and CHRISTOPHER J. LAUZEN,	)	
Defendants.	)	

MEMORANDUM OPINION

Prentice H. Marshall, District Judge

Plaintiffs Glenn L. Rudell, Jean C. Rudell, and Edward W. Bergquist, as Bankruptcy Trustee for Glenn and Jean Rudell, bring this action against defendants Comprehensive Accounting Corporation (Comprehensive), Comprehensive Business Corporation, a subsidiary of Comprehensive which defendants advise is no longer a separate entity, having merged into Comprehensive, Leo G. Lauzen and Christopher J. Lauzen. Jurisdiction is based on the existence of a federal question under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1962 (1982). Plaintiffs also assert in their memorandum in opposition to the motion to dismiss that we have diversity jurisdiction. The complaint also alleges violations of the Illinois Franchise Disclosure

Act, Ill. Rev. Stat., ch. 121½, ¶ 708 (1983), and the Illinois Consumer Fraud and Deceptive Business Practice Act, *id.*, ¶ 261, as well as common law fraud and deceit. In addition, the complaint purports to be a class action on behalf of other individual franchisees of Comprehensive's computerized accounting system.

Defendants Comprehensive, Leo G. Lauzen and Christopher J. Lauzen move to dismiss plaintiffs' amended complaint pursuant to Rules 9(b), 12(b)(1) and 12(b)(6), Fed. R. Civ. P. Defendants assert that plaintiffs lack standing to maintain this action. They also argue that the amended complaint fails to state a claim under the RICO statute. Defendants further seek to invoke the doctrines of res judicata and collateral estoppel to bar plaintiffs' claims. Defendants then assert that because plaintiffs' complaint fails to state a federal claim, this court lacks jurisdiction over the pendent state claims. Defendants also challenge the state statutory claims on statute of limitations grounds. They also assert that plaintiffs' common law action for fraud is deficient under Rule 9(b), Fed. R. Civ. P.

Standing

The original complaint in this action was filed by Glenn L. Rudell and Jean C. Rudell on June 25, 1984. On February 10, 1984, the Rudells had filed a Chapter 7 voluntary petition in the United States Bankruptcy Court for the Fourth District of Minnesota. On October 22, 1984, we granted defendants' motion to dismiss on the ground that the Rudells, as the individual debtors, could not maintain this action without the cause of action being abandoned by the Trustee in Bankruptcy of the District of Minnesota. Plaintiffs have now cured this defect by the joinder of the Trustee in Bankruptcy as a party plaintiff. We find that plaintiffs have standing to bring this action for the benefit of the Rudell estate.[1]

Res Judicata and Collateral Estoppel

The scheme which plaintiffs allege involves the defendants' advertising, offering and operation of its franchise program for a computerized accounting service. The Rudells became franchisees

of Comprehensive on September 5, 1980 when they executed various documents which included a license agreement, a sales agreement, a finance agreement, an assignment of life insurance, and an installment collateral note (collectively referred to as the "franchise agreement"). The franchise agreement contained an express provision for mandatory and binding arbitration of any disputes between the parties.[2]

On September 15, 1983, Comprehensive made a demand for arbitration, describing the nature of the dispute as a total breach of the franchise agreement by the Rudells. The Rudells were notified of the arbitration proceeding, but did not participate. On November 23, 1983, the arbitrator awarded Comprehensive the sum of $304,670.00 plus certain injunctive relief. Comprehensive then filed suit against the Rudells to confirm the arbitration award. *Comprehensive Accounting Corp. v. Rudell,* No. 83 C 8568 (N.D. Ill.) (Leighton, J.) (the "arbitration case"). The district court upheld the arbitration award. The district court's entry of judgment was affirmed, *Comprehensive Accounting Corp. v. Rudell,* F.2d , No. 84-1153 (7th Cir. April 12, 1985).

In addition to the arbitration case, Comprehensive brought an action against Glenn L. Rudell Incorporated doing business as Comprehensive Accounting Services for replevin in the Minnesota state court in the Hennepin County District Court, Fourth Judicial District, File No. 83-07256. The parties are also litigating their disputes in the Bankruptcy Court for the Fourth District of Minnesota. Comprehensive has brought an adversarial proceeding in that action to prevent the Rudells' discharge in bankruptcy.[3]

This lawsuit is the fourth encounter between the Rudells and Comprehensive. Defendants here assert that plaintiffs are estopped to raise the claims presented in the amended complaint under the doctrines of res judicata and collateral estoppel. Specifically, defendants argue that the claims of fraud which underlie the present action were issues that could and should have been raised in the initial arbitration proceeding and that these issues were raised in the arbitration case before Judge Leighton.

Plaintiffs respond, first by attempting to resolve the confusion which they assert exists from defendants' imprecise use of and commingling of principles of res judicata and collateral estoppel. They then go on to deny that their present claims were actually litigated or could have been litigated in the arbitration case before Judge Leighton.

The general rule of res judicata is that a final judgment on the merits in a court of competent jurisdiction bars the same parties from relitigating the cause of action or claim raised and decided in the former adjudication. An important corollary to this rule, which defendants invoke here, is that res judicata also bars litigation of matters that should or could have been raised in the prior proceeding. *Harper Plastics v. Amoco Chemicals Corp.*, 657 F.2d 939, 945 (7th Cir. 1981). This ability to bar relitigation of issues which could have been raised is the crucial distinction between res judicata and collateral estoppel. *Lee v. City of Peoria*, 685 F.2d 196, 198 (7th Cir. 1982).

In plaintiffs' own words, "[t]he central allegation of this complaint is that the Rudells' signatures on the various franchise documents were procured by Defendants' racketeering action," i.e. by fraud. Plaintiffs' Memorandum in Opposition to Motion to Dismiss at 12. This same claim was pleaded as a defense in the arbitration case.

> The arbitration clause is contained in a much larger accounting franchise agreement. Respondents [the Rudells] allege that the entire agreement was procured through fraud and misrepresentation, in violation of state and federal law, and that no part of the agreement should be enforced.

Response and Objections to Application and Motion for Confirmation of Arbitration Award, etc., ¶ 13 at 3; Defendants' Exhibit G.

Despite the clear pleading of a fraud in the inducement claim, plaintiffs nonetheless argue that as a practical matter there was no

realistic way the present claim could have been presented in a confirmation proceeding. We recognize that the Federal Arbitration Act both provides for the expedited handling of applications as motions, 9 U.S.C. § 6, and limits the grounds upon which the court may vacate an arbitration award, 9 U.S.C. § 10 (1982). But these two provisions of the Act did not preclude presentation of the Rudells' fraud claim. Mr. Davidson, the Rudells' attorney, declined to proceed on the fraud in the inducement claim at the hearing before Judge Leighton.

> MR. DAVIDSON: Your Honor, as a preliminary matter, I would ask for a bifurcation or severance in our response to the application and Paragraph 13 realleges the arbitration clause as contained in a much large accounting franchise agreement, respondent alleges the entire agreement was procured through fraud and misrepresentation, in violation of state and federal law.
>
> Your Honor, this was made the subject of another lawsuit in the Northern District of Illinois involving another Comprehensive franchisee. It is the intention to pursue that lawsuit. It would obviously involve matters of some complexity, documentary proof of some volume, et cetera, et cetera. We would like to proceed today—obviously we are not prepared at this time to present evidence and attempt to prove those allegations. But we would not want to proceed today on the assumption that we have waived any of those that would be merged in a res judicata decision.
>
> So we would be glad to proceed to a decision on their motion and our motion to vacate the arbitration award, subject to some provision that there would be no finding by the Court which would be binding upon us with respect to those issues.

Transcript of Proceedings in *Comprehensive Accounting Corp. v. Rudell,* No. 83 C 8568 (N.D. Ill.) January 3, 1984 at 10 - 11.[4] We note with interest that plaintiffs' counsel was aware of the possible res judicata implications of his failure to pursue the fraud in the inducement claim at the time of the confirmation hearing before Judge Leighton.

Plaintiffs offer no support for their assertion that their present claim could not have been raised before Judge Leighton. The Federal Arbitration Act limits the grounds upon which the court may vacate an arbitrator's award and thereby limits the defenses which may be successfully raised in a confirmation proceeding, 9 U.S.C. § 10. But we can find no statute or other procedural rule which would have prevented the Rudells from presenting their fraud claim as a counterclaim in the arbitration case.

Plaintiffs here cannot escape the bar or res judicata by asserting their own failure to raise matters in a prior proceeding. *Lee v. City of Peoria*, 685 F.2d at 198 - 99. That branch of res judicata which operates to bar claims which could have been brought in a prior proceeding prevents the fragmentation of causes of action and the use of alternate legal theories. This application of the doctrine promotes the efficient use of judicial resources. "An unsuccessful party may not . . . frustrate the doctrine of *res judicata* by cloaking the same cause of action in the language of a theory of recovery untried in the previous litigation." *Harper Plastics*, 657 F.2d at 945.

The doctrine of res judicata operates where a party has had a full and fair opportunity to litigate. *Lee v. City of Peoria*, 685 F.2d at 201 - 02. The Rudells have had ample opportunities to litigate their disputes with Comprehensive. First, they received notice of Comprehensive's demand for arbitration. They chose not to participate in the arbitration. And perhaps more importantly, they chose not to challenge the agreement to arbitrate in a section 4 proceeding under the Arbitration Act, 9 U.S.C. § 4. Comprehensive proceeded with the arbitration and obtained a substantial award in its favor. Comprehensive then brought suit to enforce the award. The Rudells responded, objecting to the enforcement of the award, claiming fraud in the inducement. But at the hearing, Rudells' attorney declined to present evidence and prove the allegations of fraud and misrepresentation.

We have treated defendants' motion to dismiss as a motion for summary judgment as it raises matters outside the pleadings, Fed. R. Civ. P. 12(b). Defendants' motion for summary judgment on the ground that the doctrine of res judicata bars this action is granted. Judgment will enter dismissing plaintiffs' action.

Because we have dismissed plaintiffs' action, we need not consider the other grounds for dismissal raised by defendants. Plaintiffs' motion to consolidate this case with *Perta v. Comprehensive Accounting Corp.*, No. 84 C 5484 (N.D. Ill.) is denied as moot.

ENTER:

Prentice H. Marshall
District Judge

DATED: 7-9-85

1. Plaintiffs have entitled their most recent pleading "First Amended Class Action Complaint." We need not decide at this time whether the named plaintiffs are appropriate class representatives.

2. The arbitration provision was as follows:

> D. *Mandatory and Binding Arbitration.* In the event a dispute cannot be resolved amicably, the parties mutually recognize and agree that it will be to their best interests that their differences be resolved with a minimum of time and money being expended commensurate with a due process hearing. To this end the parties agree that they will not file any lawsuits or claims against each other (except an action by COMPREHENSIVE for possession of the accounts) without first submitting their grievances to mandatory and binding arbitration. Any controversy arising out of, or relating to, this agreement or any modification or extension thereof, including any claim for damages or rescission, or both, shall be settled by arbitration as provided by the Illinois Uniform Arbitration Act and/or the United States Arbitration Act, in accordance with the rules, regulations and precepts then obtaining of the American Arbitration Association (AAA) in connection with commercial arbitration. . . .

Defendants' Exhibit B, p. 9 of an unidentified agreement in the group referred to as the franchise agreement.

3. We do not know when the adversarial proceeding was brought by Comprehensive in connection with the Rudell bankruptcy. It may be that the proceeding also preceded the filing of the instant action.

4. Neither party has advised us as to the identity of this other Comprehensive franchisee. The present action was filed on June 15, 1984. And the case of Perta v. Comprehensive Corp., No. 84 C 5484 (N.D. Ill.) which plaintiffs seek to consolidate with this action was filed sometime after June 25, 1984. Neither case was pending on January 3, 1984, the date of the hearing before Judge Leighton.